The Tatton Weekly

Trump in China and Starmer in peril

15 May 2026

This week's topics:

Waiting for relief

Inflation round-up

What the Fed can learn from the BoE

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'Give us a smile, Prime Minister. Think what this did for David Attenborough's popularity'

A caged Starmer, Mac, May 2026

Waiting for relief

The Bloomberg World Equity index is up 1.5% in sterling terms as we close the week, although virtually all of that gain comes from US stocks and a stronger US Dollar. Donald Trump's high-profile visit to China had no notable surprises, which helped stock prices. However, while Trump suggested that China may help reopen the Strait of Hormuz, there did not appear to be significant progress in resolving the Iran conflict, and China did not confirm US statements. President Xi did at least say Washington and Beijing should be "partners, not rivals" and, this afternoon, China confirmed it will take part in a "Board of Trade" as well as a "Board of Investment". That was well received by markets.

Bonds were particularly volatile in the early part of the week – and not just UK bonds. For UK bonds (gilts), the narrative has been dominated by handwringing over Keir Starmer's premiership. The UK 10-year gilt yield briefly dropped below 5% on Thursday but is back to 5.16% as we write.

Investors watch falling gilt prices rather than rising returns

Up until Friday morning, gilts had outperformed other government bonds – albeit after several weeks of underperformance. We stand by our assessment that gilt yields are higher than others because of structurally weak demand, rather than politics *per se*. One of those demand deficiencies is the Bank of England's net bond sales, which we discuss in a separate article.

Gilt struggles should be put in the context of broader bond volatility, even if that is no comfort to investors. More comforting is the fact that relative bond volatility (in terms of the effect of yield percentage point changes affecting price changes) decreases as yields go up, in purely mathematical terms (known as "convexity"). Total bond returns are also supported by the payouts from higher yields. Basically, high government yields are attractive for long-term investors – even if short-term bond traders worry about volatility.

If you think government finances will collapse, or volatility will stay so high for so long as to make even long-term bond holdings unattractive, then you will disagree that bonds are good value even at these levels. Some worry that fiscal expansion from a potential new Labour leader could do exactly that. Andy Burnham worries gilt investors the most, having said that he would expand the government deficit – but we can only speculate how much more debt would result.

Even if Burnham becomes leader, we struggle to see how UK debt and deficit metrics could get anywhere near as stretched as the US, for example. The UK government deficit was at 4.3% of GDP and falling in March whereas the US deficit is at 5.8% and rising again. And because the risks have been clear for some time, it means that investors are already pricing them into the market. The bond vigilantes are already getting paid.

Structurally weak gilt demand puts our bond market at the mercy of short-term traders. But the long-term demand is growing – evidenced by the success of recent gilt sales by the government. We are not saying prices cannot fall further; obviously, they can. But we are saying yields are likely to mean long-term investors will get a return well above inflation.

A resource squeeze?

Inflation is part of the bond market fear – not helped by higher inflation figures this week. As we discuss in a separate article, recent price rises are not all about oil. There are also intense supply pressures on metals like copper and silver, as well as certain tech goods.

The AI infrastructure spending spree is creating huge demand for metals. China is currently importing as much silver as it can get its hands on, with silver likely to become a key electricity component. Even if the world gets over the Iran shock, metals and energy demand could keep inflation high.

Bond managers are also worried about how central banks might respond to inflation. Today is Jerome Powell's last day as Federal Reserve chair – set to be replaced by the supposedly dovish

Kevin Warsh. We have heard concerns that central banks might abandon their informal (or in some cases, formal) 2% annual inflation targets, which have anchored bond yields for decades.

We see that as unlikely. Few central banks are signalling a laxer approach to inflation, with some already raising rates. Even Warsh is not a straightforward dove, as discussed separately. The 2% target might be rethought eventually – for good reason – but it is not at risk right now.

Nice view from the (Trump-Xi) summit

It is heartening that global growth has been resilient throughout the US and Israel's war on Iran, even if strong growth compounds inflation. The flipside of the AI corporate spending spree is that manufacturers are doing very well – with strong business sentiment surveys virtually everywhere.

We have even seen a pickup in global job postings, backing up recent jobless claims data from the US and dispelling any notion of an AI-fuelled job drought. Jobs are less abundant in the UK and Europe but, even in the UK, growth is surprisingly strong, as shown by recent GDP figures (showing the economy grew an annualised 2.4% in the first quarter of 2026) and despite endless commentary suggesting otherwise.

For the world economy, the final piece of the puzzle would be reigniting China. After a long period of stagnant growth, data from the world's second-largest economy shows progress. The government is eager to spend – proven by its silver imports – but the stumbling block has so often been whether Beijing can fire up domestic Chinese demand.

We suspect that came up during Trump's visit to China. We are disappointed at the lack of concrete progress towards a resolution on ending the US' war on Iran, but both the US and China seem aligned on resuming oil and gas flows as quickly as possible. Getting more out of China, whether that is building US factories or prompting Chinese consumers to buy more US products, has been a core part of Trump's agenda for a decade. Helpfully for US-China relations, Beijing wants Chinese consumers to buy more too.

Inflation roundup

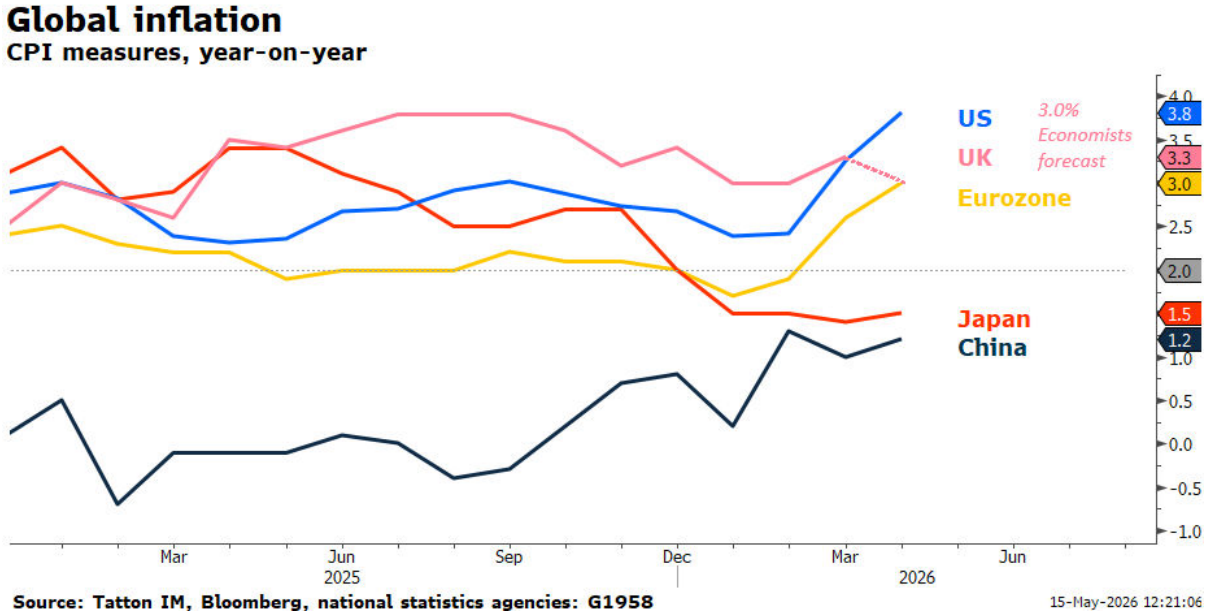
The Iran war keeps pushing prices higher. Global inflation figures from April showed a marked increase on the previous month – a 3.5% year-on-year price jump, according to JPMorgan. While the main impact is, unsurprisingly, on energy prices, the inflation spike is not all about energy. Consumer demand is staying stronger than you might expect. That is keeping prices high in other areas, making it harder to argue that this is a one-off spike.

Mostly, but not entirely, about energy

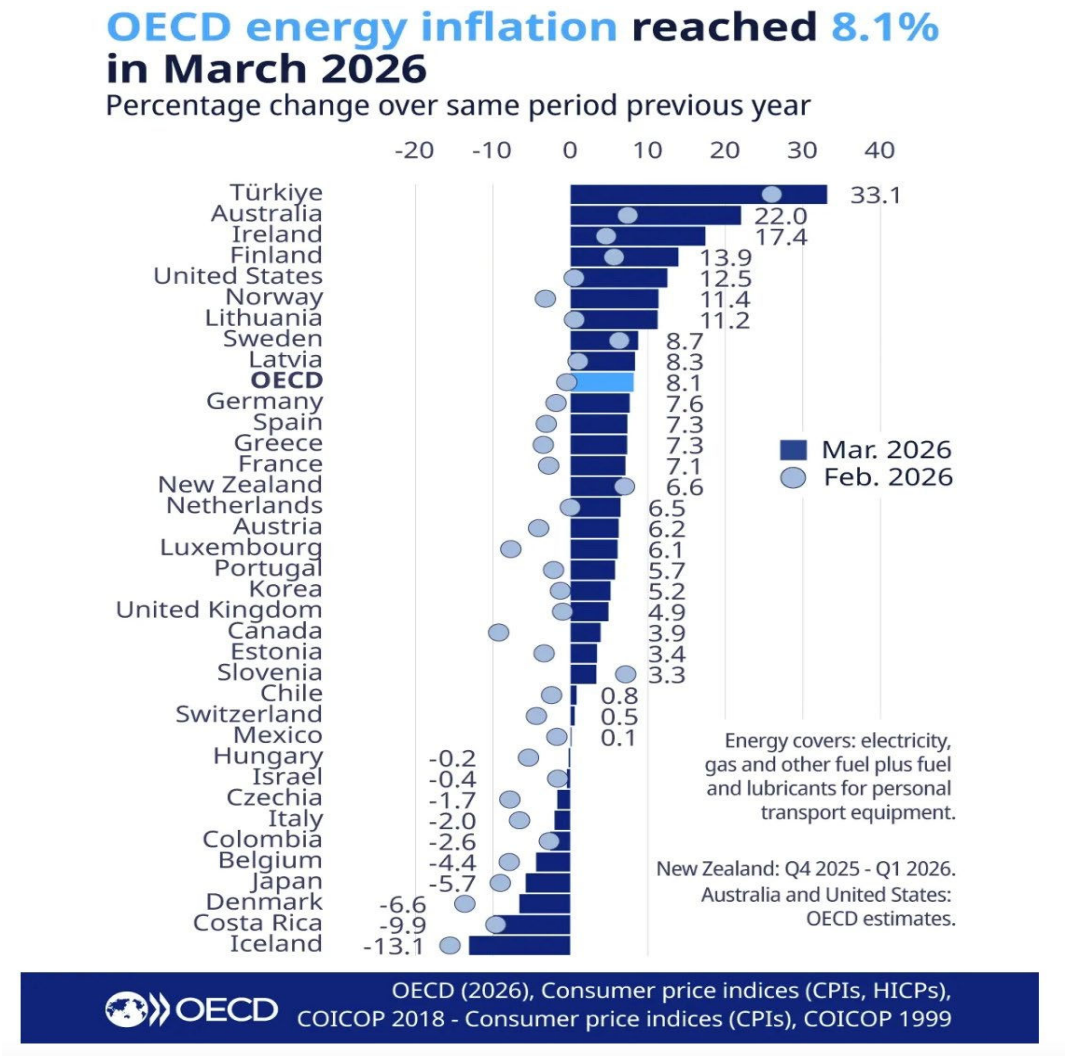
US inflation numbers were in the limelight this week. The US Consumer Price Index [CPI] jumped 3.8% year-on-year in April, above the forecast 3.7% and the highest inflation level since 2023. The Producer Price Index rose 6.4% year-on-year, a substantially greater rise.

Unsurprisingly, oil prices were the main driver. Fuel prices are up more than 50% from a year ago, and US consumers are now paying around $4.50 per gallon for gasoline. The inflation components with the highest sensitivity to oil – like transportation and other energy commodities – were the next biggest contributors.

Eurozone inflation also registered its highest reading since 2023, with a 3% increase in the year to April. UK inflation figures for April have not yet been released, but they are actually expected to fall on a yearly basis, due to special factors. We should expect faster UK inflation in May, however. The chart below shows various national CPI rates since the start of 2025:



The next chart shows how energy prices for consumers had changed in March, as a result of the war. Interestingly, the UK had a smaller jump in energy prices in March than the average among the 38 countries of the Organisation for Economic Co-operation and Development [OECD].



Some of that is down to the higher tax component in UK fuel prices – lessening the impact of the underlying oil price rise. But there is also a lack of impact from natural gas prices, in the UK and in Europe. Again, this is partly structural; electricity prices tend to be fixed over a period of months.

Europe is seen as more vulnerable to a global energy shock than the US, largely because of its reliance on natural gas imports. But, while European gas prices spiked after the US launched its war on Iran, these prices have come down significantly from the peak and have not moved much in recent days.

There were other sources of input cost inflation too. In the US, food price inflation came in at 3.2% for April – which could be related to the shortage of global fertiliser, another consequence of the war. Metals were another notable source of inflation, particularly copper and silver. This seems to be more about demand from datacentre building projects than energy costs.

Consumers keep core inflation sticky

US core inflation, stripping out volatile elements like food and energy, rose to 2.8% in April. Higher core inflation in recent months is partly a knock-on effect from the US government shutdown, and ensuing statistical blackout, last year (the missing months were recorded as zero readings, making subsequent gains look bigger). But JPMorgan analysts point out that even the smoothed underlying rate of core inflation is a little too high for comfort.

Recent economic data has suggested that US consumers are still consuming – and the inflation numbers back that up. There is little sign that higher energy prices are sapping demand elsewhere, and growth remains strong.

It should worry US policymakers – particularly an unpopular administration – that CPI inflation came in higher than wage rises. You would expect that to temper demand in the months ahead, hence limiting future inflation. But that process can take time. For example, global car prices are coming down as a result of higher fuel costs (dis-incentivising driving) but are still elevated compared to history.

Demand has not been as resilient in Europe, largely because the labour market has not kept up. In the first quarter of 2026, German employment contracted at its fastest rate since the early 2000s. This is feeding through into lower core inflation: Eurozone core inflation was 2.2% in April, down from 2.4% before the war started in February.

Central banks in a bind

The energy price spike is a conundrum for central banks. They do not want to crush economies already struggling with higher input costs, but they cannot have a repeat of 2022's 'transitory' inflation debacle. They misjudged the longer-term impacts of disparate supply-side pressures back then, letting inflation become embedded. Central bankers are clearly anxious about the same thing happening now. Norway and Australia have already raised interest rates in response to the war. The European Central Bank [ECB], Bank of England [BoE] and Federal Reserve have suggested that they may have to raise rates, but none have done so yet.

The BoE and ECB have been more hawkish (preferring higher rates) in their communications than the Fed. That difference is likely to grow when new Fed chair Warsh takes his post, given his past commitment to rate cuts. It is odd that the Fed seems more dovish than the rest, given that the resilient US economy looks like by far the least in need of support.

We should also point out that, for the US in particular, the wave of AI infrastructure investment is also adding to inflation. The need to build datacentres is pushing up metals prices and certain other tech goods and having knock-on effects on demand and employment at non-tech companies. Warsh's dovish rationale is based on the notion that AI-driven productivity growth will be disinflationary, but right now, the opposite is happening.

Odd as it sounds, inflation is not always inflationary. One-off price spikes can destroy demand. That was why central bankers kept talking about 'transitory' inflation a few years ago, and we see similar arguments now, but the latest data show that demand destruction is not happening yet.

What the Fed can learn from the BoE

Central bank appointments are rarely as blockbuster as incoming Federal Reserve [Fed] Chair Kevin Warsh. That is not just about who picked him (Trump) and why (Trump wants lower interest rates). One of the most intriguing parts of Warsh's monetary philosophy is that the central bank should reduce its role in liquidity provision to the banking system.

The Fed started buying large amounts of bonds during the 2008 Global Financial Crisis [GFC], and during subsequent crises. The money that the Fed injected into the banking system often flowed back to the Fed in the form of reserves, since there was not enough demand elsewhere. The Fed gave the banks a full money-market return on the reserves, so they would not be disadvantaged. That liquidity has sloshed around ever since, finding its way into various investments.

Those worried about what might happen without that liquidity may want to look at the Bank of England [BoE] as a possible example.

BoE bond trimming hurts UK markets

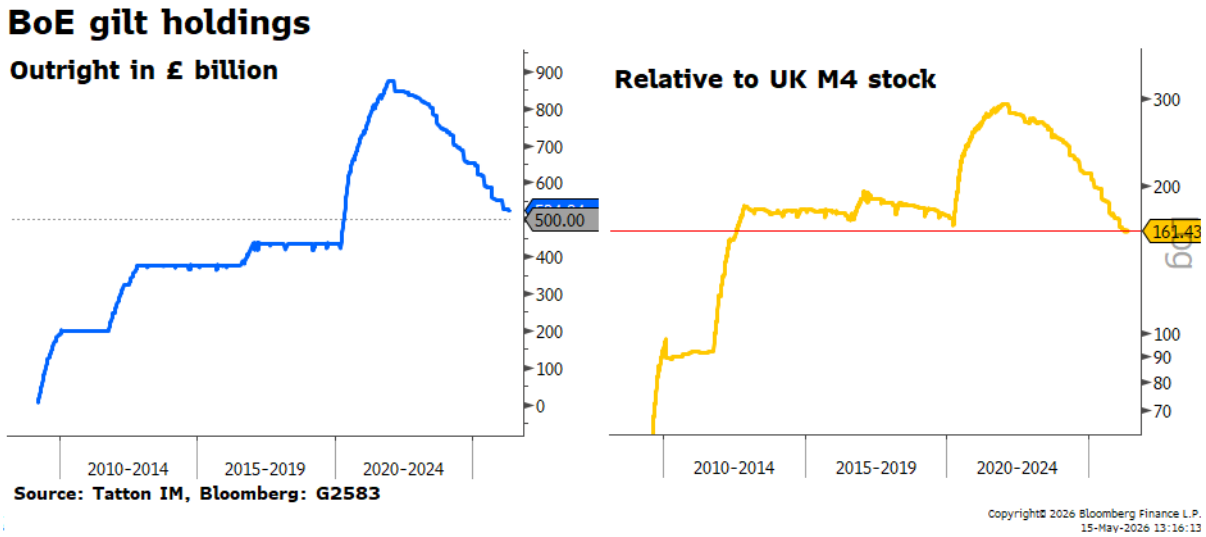
Central bank bond buying (Quantitative Easing – QE) started after the GFC and ramped up again during the pandemic. The BoE, like others, reduced its balance sheet through quantitative tightening (QT) after 2022. All major banks have tapered their QT sales in recent years but, unlike the Fed, the BoE is still a net bond seller. That is mainly through not reinvesting bonds at maturity, rather than outright sales, but the net effect on UK government bonds (gilts) is the same.

While the BoE has tapered QT in nominal terms, the balance sheet reduction does not look that tapered when you compare it to the BoE's own measure of broad money supply, called M4. As the chart below shows, the BoE's stock of gilts, relative to M4, is at the lowest it has been since 2012.

That has a damaging impact on the gilt market. Gilt commentary usually focuses on politics, but we argue that the deeper problems are structural. The stock of outstanding gilts is more heavily weighted to the long-term than other markets, and we have a higher proportion of inflation-linked bonds. That makes gilts more sensitive to inflation shocks and fiscal policy than other markets.

The BoE's balance sheet reduction compounds these problems. The bank is selling bonds into a market with structurally weak demand. Even if you ignore the politics, those factors alone explain why gilts are so much weaker than other bonds.

Reportedly, the BoE wants to reduce its balance sheet to around £500bn worth of gilts, down from a peak of £875bn in 2022. At the current pace, that target should be achieved in the next few months. All else being equal, then, you would expect the BoE to loosen its liquidity policy soon, relatively speaking.



Distortion works both ways

One of the main arguments for central banks reducing their balance sheets is that QE was meant to be emergency support. Central banks were never supposed to be providers of ongoing liquidity, but that is what they have now become. The system became dependent on that liquidity, distorting asset markets. Many argue that excessively high equity valuations – particularly for big tech companies – are an unwelcome legacy of QE. That is exactly the argument Kevin Warsh has made.

Reforming the way central banks provide liquidity is a worthy goal, but we cannot pretend that enacting these reforms is somehow market neutral. If QE warped markets in one direction, QT warps them in the other. Markets have shown several times over the last two decades that the removal of liquidity often leads to price volatility. We saw that during the so-called 'Taper Tantrum' in 2013, and again during the explosion of implied-volatility options in 2018, nicknamed 'Volmageddon'.

The BoE also cannot be surprised that unilaterally reducing your balance sheet, when others maintain theirs at higher levels, hurts domestic assets relative to others. Net bond sales increase the term premium for bonds – the extra amount investors demand for lending over the long-term compared to the short-term. The knock-on effect is a rise in the equity risk premium – the return investors demand for taking on risk.

Lessons for the Fed

For Warsh, the crucial caveat is that there is a trade-off between liquidity provision and interest rates. He wants to wean the financial system away from central bank cash but, in return, the Fed can offer lower interest rates. That should mean a better-functioning bank lending system, where private banks shoulder the responsibility of liquidity creation, not the central bank.

That, in turn, should mean a more vibrant economy that runs off its own steam. The trade-off makes Warsh more of a balance sheet pragmatist, while the BoE is a purist. If Warsh's Fed gets this trade-off right, it should be a boon for small US companies in particular, which rely more on bank lending than capital market lending.

Even so, reducing support for long-term bonds while lowering short-term interest rates means that the yield curve (the difference between long and short-term yields) will steepen. That still means a higher yield in return for taking a bond with a longer maturity (the term premium – the extra return investors demand for lending over a longer period rather than a shorter one), and a greater preference for cash. That could be a risk for US equity valuations, just as we have seen in the UK. If this happens at the same time as the dollar keeps weakening, it could get nasty for US assets.

Warsh knows that is a risk, which is why he seems to favour a slow and cautious approach to balance sheet reduction. Even if he did not, the Fed works by committee, so slow-and-steady reform is the best he can hope for. That should limit the negative impacts from a potential reduction in the Fed's balance sheet, but it does not remove them entirely. The BoE has been similarly steady in its reduction – but the impacts have still been felt.

Tatton Investment Management

15 May 2026

Global Equity Markets	15-May			Technical		Valuations			
Market	Level	% 1 Week	% 1 Week (GBP)	Short	Medium	Div YLD %	LTM PE	NTM PE	10Y AVG NTM PE
UK FTSE 100	10186	-0.6	-0.6	↘	→	3.2	14.8	12.6	12.7
UK FTSE 250	22407	-2.0	-2.0	↘	→	3.7	10.8	11.8	13.3
UK FTSE All-Share	5470	-0.7	-0.7	↘	→	3.3	14.4	12.5	12.7
FTSE Small x Inv_Tsts	6259	-1.4	-1.4	↘	→	4.3	20.9	9.5	10.0
EU STOXX ex UK	774	-1.0	-0.3	↘	→	3.0	17.1	15.2	15.1
France CAC 40	7959	-2.0	-1.2	↘	→	3.3	16.6	14.2	14.1
Germany DAX 40	23929	-1.9	-1.2	↘	→	2.7	17.1	14.7	13.3
US S&P 500	7413	+0.3	+2.4	↗	↗	1.1	27.1	21.2	19.0
US NASDAQ comp	26304	+0.7	+2.8	↗	↗	0.5	39.3	29.7	26.2
Japan Nikkei 225	61409	-2.1	-1.2	↗	↗	1.4	22.9	21.9	18.6
World Bloomberg	2550	-0.4	+1.7	↗	↗	1.6	23.2	18.0	16.6
China Bloomberg	1351	-2.0	+0.1	→	↘	2.2	15.8	12.7	12.5
Emerging Bloomberg	1790	-2.3	-0.2	↗	↗	2.1	17.9	12.0	12.5

FTSE100 Top 6		S&P Global Top 6	(GBP terms)	Global Sectors			(GBP terms)
Company	%	Company	%	Sector	%	Sector	%
Intertek	+14.2	Delivery Hero	+42.6	Tech	+2.5	Staples	+3.0
British American Tobacco	+14.0	Cisco Systems	+23.9	Financials	+0.9	Energy	+5.6
Hiscox	+13.5	United Microelectronics	+22.4	Health	+3.3	Materials	-0.7
Compass	+11.2	Yamaha Motor	+19.7	Discretionary	-0.5	Utilities	+0.1
Metlen Energy & Metals	+7.6	Sony	+15.8	Industrials	-0.1	Real_Estate	-0.9
Legal & General	+5.0	Palo Alto Networks	+15.5	Communicatic	+1.1		

FTSE 100 Bottom 6		S&P Global Bottom 6	(GBP terms)	Fixed Income		
Company	%	Company (GBP terms)	%	Govt bond	%Yield	1 wk chg
3i	-14.6	Adecco	-19.6	UK 5yr Gilt	4.68	+0.22
Burberry	-12.8	CSL	-17.5	UK 10yr Gilt	5.16	+0.24
Airtel Africa	-11.2	SMC	-17.4	UK 15yr Gilt	5.57	+0.26
Babcock Int'l	-9.6	Localiza Rent a Car	-15.9	US 10yr Treasury	4.57	+0.21
SSE	-8.8	Nexon	-15.3	France 10yr OAT	3.79	+0.17
Barratt Redrow	-8.6	Doosan Enerbility	-14.9	Germany 10yr Bund	3.14	+0.14
				Japan 10yr JGB	2.71	+0.23

Currencies			Commodities			UK Mortgage Rate Estimates		
Pair	last	%1W	Cmdty	last	%1W	Rates (LTV c.75%, no fee)	15-May	15-Apr
USD per GBP	1.335	-2.0	Oil Brent $:bl	108.41	+7.1	UK BoE base rate	3.75	3.75
GBP per EUR	0.871	+0.7	Gold $:oz	4544	-4.0	2yr fixed	4.75	4.45
USD per EUR	1.163	-1.2	Silver $:oz	76.70	-5.2	3yr fixed	4.86	4.37
JPY per USD	158.66	+1.3	Copper $:lb	629.6	+0.3	5yr fixed	4.67	4.43
CNY per USD	6.813	+0.2	Alumnm $:mt	3741	+5.1	10yr fixed	5.21	4.82
USD per Bitcoin	79,216	-0.9	Agriculture BBG	58.04	-0.2	Standard variable	6.60	6.60

Where possible, prices taken levels at 15 May 3:00 PM (today) and 08 May 3:00 PM. Mortgage estimates from moneyfacts.co.uk
LTM PE is the index price as a ratio of last 12 months earnings. NTM PE is next 12 months earnings.

Please note: Data used within the Personal Finance Compass is sourced from Bloomberg/FactSet and is only valid for the publication date of this document. The value of your investments can go down as well as up and you may get back less than you originally invested.

Lothar Mentel